The Type 2 Investor

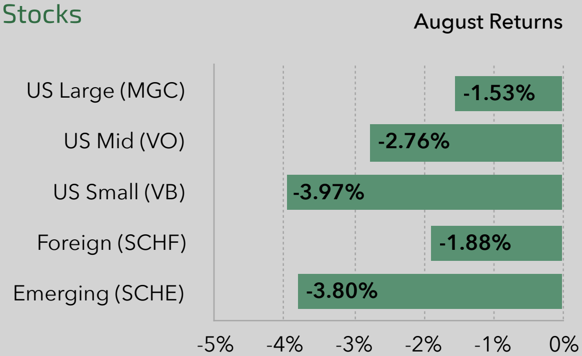
September 10, 2019

August 2019

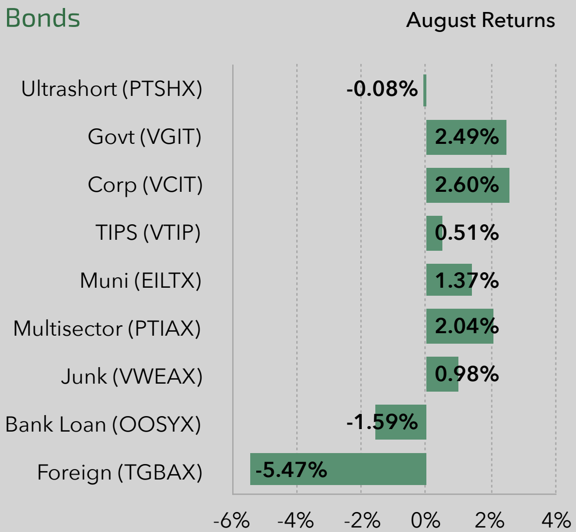
Economic Data

- US payrolls were below expectations with 130,000 new jobs added in August; wage growth and the unemployment rate held steady at 3.2% and 3.7% respectively
- Retail sales surprised to the upside in July, rising 0.7% in part thanks to Amazon Prime Day
- Y/y inflation (CPI) rose to 1.8% in July
- Existing-home sales rebounded a little in July, increasing 2.5%

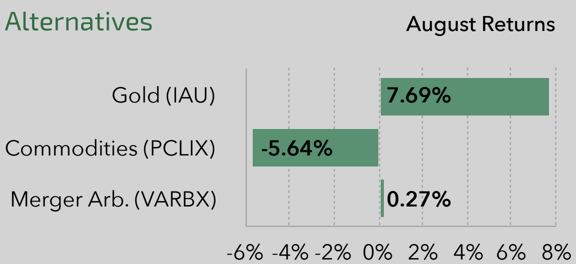
Stocks



Bonds



Alternatives



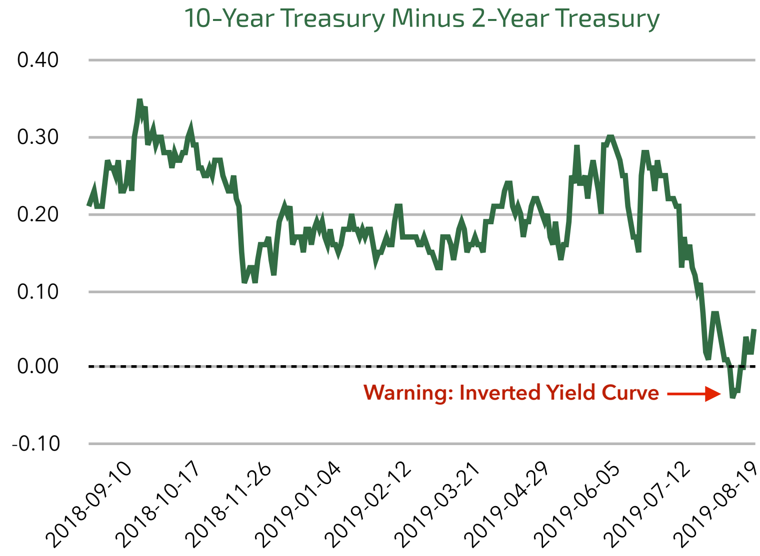
Performance data provided by Morningstar.

The brain uses two systems to process information. The first type is intuitive but lazy, rapidly forming judgements with no conscious input. The second system is slow, reflective, and is not guided by emotions. It is that second system – type 2 – that we want in control of our investment portfolios.

We Were Inverted

I've talked a few times since December about the shape of the US Treasury yield curve. In normal conditions, the yield curve slopes upward, meaning that as you go further out in maturity, yields get higher to compensate investors for the increased risk. Makes sense. However, since December the slope of the yield curve has, in various ways, found itself a bit out of whack. It started with an inversion between the 2- and 5-year bonds, meaning shorter-term 2-year bonds were yielding more than 5-year bonds. Then in April, the inversion expanded to include the 1- and 10-year bonds.

But the big metric that most in the nerdery follow—and view as an indicator of an impending recession—is the spread between 2-year and the 10-year, which remained positive until August 27, when it inverted for first time in 12 years. In fact, the entire yield curve is inverted at this point, as longer-dated Treasuries continue to rally and the 30-year Treasury yield hit record all-time lows. The probability of recession rises to 91.9% once the spread between the 2-year and 10-year hits zero, according to Piper Jaffray.

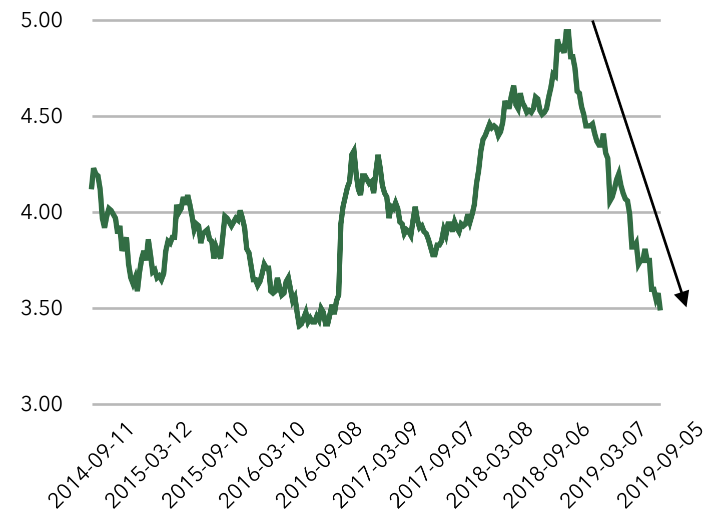


Source: Federal Reserve Bank of St. Louis

Should You Refinance?

With the drop in long-term rates, mortgage rates have also fallen 145 basis points in the past ten months, from a recent high of 4.94% in November to their current levels at 3.49%. This essentially puts rates back down to the lows we had in the late summer of 2016.

30-Year Fixed Rate Mortgage Average



Source: Freddie Mac

Tactical Asset Allocation					
Asset Class	Heavy Under-weight	Under-weight	Neutral	Over-weight	Heavy Over-weight
Fixed Income			●		
Ultrashort					●
US Govt.		●			
TIPS				●	
Multisector			●		
Bank Loans	●				
Foreign Bonds			●		
Equities	●				
Large Cap	●				
Mid Cap	●				
Small Cap	●				
Developed Intl.		●			
Emerging			●		
Alternatives					●
Commodities					●
Hedging					●

So is now a good time to refinance your mortgage? Everyone's situation is a little different, so there are a few things you need to consider before knowing whether it's a good decision or not.

First, how much lower will the rate be? If you're just going to be knocking one-eighth or a one-quarter of a point off, it's most likely not worth it. However, once you get around a 0.75% reduction, it's probably worth a look.

Second, how much longer do you plan on keeping your mortgage? If you are planning to move in the next couple years, or perhaps planning to pay your mortgage off soon, you can probably just stick with the loan you currently have. However, if you are planning to sit tight longer it makes refinancing much more compelling.

Third, what are the points and closing costs? If refinancing were free, we'd do it every time rates fell below our current mortgage. But there are points, closing costs, and appraisal costs that need to be factored in when making your decision.

Fourth, if you are currently paying for private mortgage insurance (PMI), are you in a position to eliminate it by refinancing? This could be the case if you've paid down enough of your mortgage and/or the appraised value has increased enough to get you to an 80% loan-to-value ratio, thus eliminating the need for the added cost of PMI and making refinancing all the more desirable. It should also be considered if you are in a position to bring money to the table to get it to 80%.

There are clearly a few variables to consider here, so simple rules of thumb aren't always the best to follow. If based on the above considerations you think it might be a good idea to refinance, please reach out and I'd be happy to run the numbers for you to see if it makes sense.

Ryan P. Layton, CFA
p: 612-810-2230
e: ryan@emeraldspark.com

Binge Box

Mindhunter (Netflix)

After no fewer than three people of varying television tastes recommended *Mindhunter* to me, I decided to give it a shot hoping it would help me pass the time during a very long airport layover. Now I'm hooked. The show is set in 1977 and centers around frustrated FBI negotiator Holden Ford and the genesis of the FBI's Behavioral Sciences Department, a pioneering unit that started as a two-man special agent team in the basement at Quantico. They interview a number of offenders in an attempt to understand a new class of criminal—the serial killer. The thriller is far more academic than action, which is one of the reasons I like it so much. I just finished season 1, and luckily season 2 is now available.

About EmeraldSpark

EmeraldSpark Investments, LLC is a Registered Investment Adviser based in Chicago, IL. We were founded by Ryan P. Layton, CFA in 2015 to provide personalized financial planning and fiduciary investment management services to select clients. Our investment process blends the foundations of Modern Portfolio Theory with the latest research in the field of behavioral finance. We specialize in asset allocation and investment due diligence to help provide our clients with investment strategies personalized to match their specific goals and risk comfort zone.

This Newsletter has been prepared by EmeraldSpark Investments. Information contained within has been obtained from sources believed to be reliable, but we do not guarantee its accuracy, completeness or fairness. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by EmeraldSpark Investments to buy, sell, or hold any security. Views and opinions are current at the time of writing and may change. Before acting on this material, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice. Past performance is not indicative of future results.

EmeraldSpark

NOT FDIC INSURED | NOT BANK GUARANTEED | MAY LOSE VALUE